United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING EN BANC

75-4087, 76-4110

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

SAMUEL H. SLOAN,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of Orders of the
Securities and Exchange Commission

PETITION FOR REHEARING AND SUGGESTION THAT REHEARING BE EN BANC

B P/S

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PETITION FOR REHEARING AND SUGGESTION
THAT REHEARING BE EN BANC

TO: The Honorable Harold R. Medina,
The Honorable Robert P. Anderson,
The Honorable Murray I. Gurfein:

The Securities and Exchange Commission, appellee herein, respectfully petitions for rehearing of the panel's decision of November 18, 1976, insofar as it deals with the Commission's authority to issue successive summary trading suspensions, and respectfully suggests that the rehearing be en banc.

That decision held that the Securities and Exchange Commission is without the power, under Section 12(k) of the Securities Exchange Act, 15 U.S.C. 78l(k), ever to issue consecutive summary ten-day trading suspensions of a stock. This Court "directed" the Commission "to discontinue forthwith its adoption and use of successive ten-day suspension orders to order the suspension of trading in a security for an extended period, i.e ,in excess of ten days" (slip op. 566).

We submit that this decision is erroneous and could have a substantial detrimental effect upon public investors, as well as upon the fairness, honesty and orderliness of the national securities markets, which the Commission is charged with protecting under the federal securities laws.

The decision arose in an appeal by Samuel H. Sloan (the revocation of whose broker-dealer registration was simultaneously affirmed by this Court) from several Commission orders issued pursuant to Section 12(k) that were among a series of such orders suspending trading in the stock of Canadian Javelin Ltd. ("CJL") on the American Stock Exchange and on the over-the-counter market for continuous ten-day periods from April 29, 1975, through

May 2, 1976.[1/] At the time the oral argument was heard by this Court on October 13, 1976, no suspension order of the Commission had been in effect with respect to CJL stock since May 2, 1976. Mr. Sloan claimed no connection with CJL other than that he holds 13 shares of its stock[2/] and desires to purchase more (Appendix 93).[3/]

We submit that, under the circumstances, the issue decided by this Court was moot, and, in any event, that Mr. Sloan was not "a person or party aggrieved" within the meaning of Section 25 of the Securities Exchange Act, 15 U.S.C. 78y, the provision which gives this Court jurisdiction to review Commission orders.

1/ The orders prior to June 4, 1975, were issued pursuant to the predecessors of new Section 12(k) of the Securities Exchange Act, Sections 15(c)(5), 15 U.S.C. 78o(c)(5), 78 Stat. 574, and 19(a)(4), 15 U.S.C. 78s(a)(4), 48 Stat. 898.

2/ In March 1976, at the time Mr. Sloan sought Commission review of various trading suspension orders, he indicated that CJL stock was trading on the Montreal Stock Exchange at prices "between $1.50 and $2.00 per share." The Montreal exchange has since suspended trading in the stock. Despite the fact that no order of the Commission now suspends trading in CJL stock, it is not trading on the American Stock Exchange because of an order of that exchange suspending its trading. Mr. Sloan has stated that the stock is not being quoted by over-the-counter dealers because of the Commission's Rule 15c2-11, 17 CFR 240.15c2-11, which, pursuant to Section 15(c)(2), 15 U.S.C. 78o(c)(2), defines as a "fraudulent, manipulative and deceptive practice" the publishing by a broker-dealer of "any quotation for a security" under certain circumstances unless the broker-dealer has certain designated information about the issuer and furnishes this information in advance to the inter-dealer-quotation-system.

3/ The current opinion noted that the Commission "suspension orders frustrated his trading in CJL stock, including short sales. . ." (slip op. 565). In Sloan v. Securities and Exchange Commission, 527 F. 2d 11 (1975), certiorari denied, 44 U.S.L.W. 3719 (June 15, 1976), this Court, in connection with the discussion of Mr. Sloan's standing, referred to Mr. Sloan's argument made in that case that the trading suspensions prevented him from purchasing CJL stock to cover short sales in that stock he had made prior to the suspensions. Mr. Sloan did not claim in the present appeal that he was engaged in any short sale.

More importantly, on the merits, the panel of this Court assumed that the Commission's suspension power is to be applied in a manner

(a) that would prevent its use in important instances,

(b) that is inconsistent with a previous decision of another panel of this Court, and

(c) that is contrary to the Congressional intent as expressed in its legislative history.

The panel's decision appears to be based upon a misreading of the pertinent legislative history in two respects. First, the panel overlooked the fact that a Senate committee report--not merely "a few comments by individual senators and congressmen" (slip op. 562)--specifically accepted the Commission's practice of repeating ten-day suspensions at the time the committee recommended legislation that was adopted by Congress enlarging the Commission's suspension power to include suspension of trading in over-the-counter markets. And second, the panel overlooked the fact that the Commission's power, "with the approval of the President, summarily to suspend all trading on any national securities exchange or otherwise, . . . for a period not exceeding ninety days" was not designed for the summary suspension of trading in shares of individual corporations.

Before setting forth the bases for the foregoing statements, we wish to emphasize that the Commission does not contend that its ten-day summary suspensions of trading in a stock may not be subject to court review by a person actually aggrieved. It does contend, however, that an order of the Commission renewing a summary suspension should be set aside only if it can be shown that the Commission abused its broad discretion.

This Court's Determination as to the Application of the Suspension Provisions of the Securities Exchange Act.

The panel read Section 12(j), 15 U.S.C. 78l(j), and Section 12(k) together and determined "that the congressional scheme for empowering the SEC to suspend trading in a stock or stocks for specified periods, authorized summary action for ten days and/or ninety days to meet emergency situations, to protect the public interest and afford protection of investors. For suspensions required for periods in excess of ninety days but not in excess of twelve months, a notice and a hearing prior to suspension are required" (slip op. 564).

Because the ninety-day suspension may be had under Section 12(k) only "with the approval of the President," under the panel's construction there would presumably be no way (1) for the Commission to suspend trading in a security for more than ten consecutive days without a Presidential order or a timeconsuming and limited-purpose hearing contemplated by Section 12(j) or, (2) even with a Presidential order, to suspend trading for more than ninety days without such a hearing. And to do so at any such hearing, the Commission, under Section 12(j), would have to find on the record that the issuer of the security had failed to comply with some provision of the Securities Exchange Act or of the rules thereunder.

The Difficulties that Would Arise from This Court's Construction.

By reading Section 12(j) and Section 12(k) together in the way it did, the panel appears to have assumed that consecutive trading suspensions are necessary solely as a result of violations of the federal securities laws committed by the issuer. Frequently they are. But other reasons also dictate the need for continued suspensions. For example, ongoing manipulative activities with respect to a stock would warrant summary suspension of trading in that stock. Yet, those activities might be, and often are, carried on by

persons other than the issuer. As stated by a Congressional committee on one of the occasions when the Commission's suspension power was being considered:

> "The Commission could invoke this suspension power in those cases in which fraudulent or manipulative practices of the issuer or other persons have deprived the security of a fair and orderly market, or where some corporate event makes informed trading impossible and provides opportunity for the deception of investors." 4/

Thus, if the Commission is not in a position to prove that an apparent manipulation is caused by an issuer, or if it is clear that the manipulation is caused by unrelated third persons, under the panel's decision the Commission could never suspend trading in a stock for more than a ten-day period, except by obtaining approval of the President.

Where the Commission is unable promptly to determine who are the persons engaging in manipulative conduct, the public interest and the protection of investors may require one or more repeated summary suspensions. Even if such a suspension is required by reason of suspected manipulative practices of the issuer, it would seem almost impossible for the Commission, within a ten-day period, to have a hearing on notice and to be able to make a finding on the record that the company was violating the Act. Alternatively, the Commission often cannot obtain sufficient evidence within ten days to alert public investors to the nature of the problem, through an enforcement action or otherwise. Compare Rule 65(b) of the Federal Rules of Civil Procedure, which implicitly assumes that a judge may not be in a position to determine whether a preliminary injunction should issue within the ten-day period of a temporary restraining order and permits such an order to be extended for another ten days.

In connection with trading in the stock of Pelorex Corporation, the the Commission initially suspended trading on January 16, 1973, "because

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4/ S. Rep. No. 379, 88th Cong., 1st Sess., p. 66 (1963) (emphasis added).

of questions raised concerning the recent unusual market activity in the common stock." The bid price of the stock had risen from $65 in November 1972 to $100 by January 1973, during which period there was no current information about the issuer. The Commission found it necessary to suspend trading for further ten-day periods through September 2, 1973.[5/] It was not until August 27, 1973, that it was able to file a complaint to enjoin Pelorex and its president from further violating the antifraud provisions of the Securities Exchange Act, inter alia, by "conveying to certain persons material non-public information concerning the existence of [certain] contract negotiations." On that date the defendants consented to a permanent injunction without admitting or denying the allegations in the Commission's complaint.[6/]

An instance respecting activities by persons other than the issuer was involved in the Commission's summary trading suspension of the stock of Power Conversion, Inc., on October 6, 1972. Among other reasons, the suspension resulted from "the unusual market activity in Power's securities and the lack of information to account for the activity."[7/] The stock had been publicly offered in March 1972 at $5 per share, and prior to the suspension the bid price had risen as high as $45-1/4. In the two trading days prior to the suspension, the bid price declined from a high of $39-3/4 to a low of $5.[8/] The company pointed out in December 1972 that it knew "of no internal development . . . to justify the rapid price increase . . . or its subsequent rapid price decline."[9/]

5/ Securities Exchange Act Release No. 9955 (January 17, 1973). See also Securities Exchange Act Release No. 10365 (August 27, 1973).

6/ Securities Exchange act Release No. 10365.

7/ Securities Exchange Act Release No. 9810 (October 10, 1972). See also Securities Exchange Act Release No. 10002 (February 12, 1973).

8/ Securities Exchange Act Release No. 10002.

9/ Id.

Subsequently, the company indicated that a trader at one of the marketmakers in Power "was deeply involved in a scheme to defraud and manipulate the market in Power."[10/] It was not until this information could be disseminated that the Commission believed that trading in Power stock should resume on February 17, 1973.

A series of trading suspensions in the stock of American Agronomics Corporation also illustrates the problems raised by the panel's decision. On March 19, 1975, the Commission filed an injunctive action against certain defendants apparently not connected with the company, inter alia, alleging that they had manipulated the company's stock by effecting wash sales and matched orders.[11/] The Commission initially suspended trading in the stock on January 3, 1975, when questions arose "concerning the market activity of the stock,"[12/] and continued to suspend trading in the stock for ten-day periods until after the district court in May 1975, pending decision on the Commission's motion for a preliminary injunction, entered an order which enjoined the defendants, among other things, from directly or indirectly purchasing, selling or otherwise disposing of any shares of American Agronomics Corporation's stock.[13/] If trading had been permitted to resume sooner, the defendants might well have continued their manipulative scheme to the detriment of public investors.

While a ninety-day summary suspension of stock might be sufficient to take care of many problems of this sort, the Commission has never read the statute to empower the President to approve a trading suspension in a

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10/ Securities Exchange Act Release No. 10002.

11/ Securities Exchange Act Release No. 11303 (March 19, 1975).

12/ Securities Exchange Act Release No. 11164 (Jan. 3, 1975).

13/ Securities Exchange Act Release No. 11438 (May 22, 1975).

particular stock; rather, as we point out below, it has assumed that this power is reserved for suspension of all trading on an exchange or exchanges.

The Inconsistency of This Panel's Holding with the Holding in Sloan v. Securities and Exchange Commission, 527 F. 2d 11 (C.A. 2, 1976).

In directing the Commission "to discontinue forthwith its adoption and use of successive ten-day suspension orders to order the suspension of trading in a security for an extended period, i.e. in excess of ten days" (slip op. 566), the current opinion emphasizes the panel's view that the Commission has no authority to order summary suspensions in a particular stock that continue an earlier suspension, regardless of the detriment to investors or the clear impairment of the fairness, honesty, or orderliness of the trading markets in that stock. In an earlier opinion, rendered by a different panel, responding to Mr. Sloan's previous challenge of Commission trading suspensions in CJL stock, this Court said (527 F. 2d at 12, emphasis supplied):

> "We consider . . . [petitioner's] blunderbuss attack frivolous except for his allegation that the 'tacking' of ten-day summary suspension orders by the SEC for an indefinite period constitutes an abuse of that agency's authority and a deprivation of due process . . . . We cannot decide . . . [the question] on the record before us. The record is entirely silent as to the reasons for the second series of suspensions, commencing in April of this year; we cannot tell if they are based on substantial evidence, and hence cannot decide if they amount to an abuse of discretion by the SEC."

Had the panel of this Court deciding that case been of the view that the Commission had no power to order anything more than a single ten-day summary trading suspension, there would have been no need for it to have had a record to determine the "reasons" for the successive suspensions.[14/]

14/ The current opinion states that in the oral argument of the earlier case, the Commission "offered to grant petitioner Sloan 'some sort of administrative hearing'" (slip op. 560) and that thereafter the (continued)

The Legislative History Approving Repeated Ten-Day Summary Suspensions.

Former Section 15(c)(5) of the Securities Exchange Act, enacted in 1964, extended the Commission's summary suspension power to over-the-counter securities--a power theretofore limited by the language of former Section 19(a)(4) to securities traded or registered national exchanges. The report of the Senate Committee on Banking and Currency, which was considering that legislation, clearly reflects (a) that the Committee was aware of the Commission's practice of repeating ten-day suspension orders, (b) that the Committee accepted the practice and (c) that the Committee expected the practice to continue at the time it recommended that former Section 15(c)(5) be added to the Securities Exchange Act. The report stated:

> "The Commission has consistently construed section 19(a)(4) as permitting it to issue more than one suspension if, upon reexamination at the end of the 10-day period, it determines that another suspension is necessary. The committee accepts this interpretation. At the same time the comittee recognizes that suspension of trading in a security is a drastic step and that prolonged suspension of trading may impose considerable hardship on stockholders. The committee therefore expects that the Commission will exercise this power with restraint and will proceed with all diligence to develop the necessary facts in order that any suspension can be terminated as soon as possible." 15/

14/ (continued)
Commission refused "to give him the above-mentioned administrative hearing . . ." (id. at 561). The Commission did, however, adopt a procedure considering objections to summary suspensions, which is set forth at Appendix 121-122. This procedure was substantially followed in the Commission's consideration of Mr. Sloan's petition. In accordance with that procedure, the Commission denied Mr. Sloan an evidentiary hearing apparently because it was of the opinion that the petition of Mr. Sloan did not present a genuine issue as to any material fact that was pertinent to the trading suspensions of CJL in effect at that time. See Appendix 85-86.

15/ S. Rep. No. 379, 88th Cong., 1st Sess. (1963), pp. 66-67 (emphasis added).

In connection with the recent 1975 Amendments to the Securities Exchange Act,[16] which resulted in new Sections 12(j) and 12(k), the Senate Report of the Committee on Banking, Housing and Urban Affairs, recommending adoption of those amendments, stated that the proposed Section 12(k) would "consolidate in one place the power the SEC presently has . . . to" issue summary trading suspension orders.[17] The Commission has consistently taken the position that it could, for good cause, renew summary ten-day trading suspensions.[18] That consistent statutory construction is entitled to judicial deference.[19] Where Congress revisits the statutory provision and acquiesces in the agency's construction, the Supreme Court has held that Congress must be deemed to have adopted the agency's construction.[20] A fortiori, where, as here, the Congress explicitly acknowledges the agency's construction and indicates that it "accepts this interpretation," this Court should not lightly reject the agency's settled interpretation of the Act.

The Legislative History Respecting the Ninety-Day Suspension with the Approval of the President.

The present Section 12(k) of the Act authorizes the Commission "with the approval of the President, summarily to suspend all trading on any national

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16/ Pub. L. No. 94-29, 89 Stat. 97 (June 4, 1975).

17/ S. Rep. No. 94-75, 94th Cong., 1st Sess. (1975), p. 106 (emphasis added).

18/ See, e.g., Hearings on H.R. 6789, H.R. 6793 and S. 1642, 88th Cong. 1st Sess. (1963), Part I, 219. See also II Loss, Securities Regulation 854 and n.238 (1961 ed.).

19/ Red Lion Broadcasting Co. v. Federal Communications Commission, 395 U.S. 367, 381 (1969), quoted with approval in New York Dept. of Social Services v. Dublino, 413 U.S. 405, 421 (1973). See also Udall v. Tallman, 380 U.S. 1, 16-18 (1965).

20/ Costanzo v. Tillinghast, 287 U.S. 341, 345 (1932).

securities exchange or otherwise, in securities other than exempted securities, for a period not exceeding ninety days" (emphasis added). The panel decision viewed the quoted provision as establishing "an additional summary suspension procedure" which could be used to suspend the trading of a "stock or stocks" (slip op. 563-564) for periods in excess of ten days, but not more than ninety days. The Senate report, recommending the adoption of former Section 19(a)(4), the original provision authorizing the issuance of trading suspension orders to this effect, makes clear, however, that this authority was designed to permit the Commission, with the consent of the President, "to close an exchange for 90 days."[21/] Similarly, the House report at that time reflects that the section was intended to permit the Commission with the consent of the President "summarily to suspend all trade on a registered exchange for not more than ninety days."[22/]

The 1975 Amendments to the Securities Exchange Act extended the Commission's power to suspend "all trading on a national securities exchange" that had been contained in former Section 19(a)(4) by adding the words "or otherwise" to that grant, thus enabling the Commission to seek the President's concurrence in the suspension of all trading in the over-the-counter market as well as in the exchange markets. The Report of the Senate Committee on Banking, Housing and Urban Affairs explained: "The SEC's power, with the approval of the President, to suspend summarily all trading on a national securities exchange would be continued and extended to include the power to

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21/ S. Rep. No. 792, 73rd Cong., 2d Sess. (1934) p. 13 (emphasis added). See also comments of Senators Fletcher and Hastings, 78 Cong. Rec. 8490-8491 (1934).

22/ H.R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934), p. 25 (emphasis added).

prohibit trading in all securities, other than exempted securities, otherwise than on an exchange.[23/]

In view of the language of the statute, read with the legislative history quoted above, it does not appear that Congress ever contemplated that this authority "to suspend all trading for ninety days" was to be used with respect to a particular security, as the panel decision held, and we are aware of no other authority that suggests it might be so used. The Commission, to date, has never asked the President to consent to a suspension pursuant to this provision because, since 1934, there has never been the kind of an emergency for which it believes the statutory provision was designed.

The Reasonableness of the Commission's Intepretation.

The Commission's policing of the securities markets is designed to protect investors from fraudulent and manipulative practices. As we have seen, pages 5-7, supra, there are situations where the Commission is required to suspend trading for successive ten-day periods to maintain orderly capital markets. Nothing in the statute states that there may not be repeated ten-day summary suspensions, so long as the Commission finds the statutory prerequisite --that the public interest requires the suspension.[24/] Moreover, the courts can

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23/ S. Rep. No. 94-75, 94th Cong., 1st Sess. (1975), p. 106 (emphasis supplied).

24/ Cf. Hagen Investments, Inc. v. Securities and Exchange Commission, 460 F. 2d 1034 (C.A. 10, 1972). A rule was there challenged that had been promulgated pursuant to a by-law authorizing the Board of Governors of the National Association of Securities Dealers, Inc., ("NASD") to adopt emergency rules without a membership vote "for a period not to exceed the duration of the emergency, or 60 days, whichever is less" (id. at 1037). The court there sustained the Commission's holding that the NASD had properly reenacted this rule every sixty days for about three years, noting that a "narrow construction . . . would seriously impair the ability of the Board . . ." to deal with "the back office problems which resulted from the high volume of securities transactions" during the period involved (id. at 1035, 1037).

determine whether, by a renewal of a particular suspension, the Commission has abused its discretion and, as one of the factors in that regard, can consider the length of time of the total suspension.

To say, however, that the Commission cannot ever renew a summary trading suspension raises difficult questions. If the Commission finds that the public interest requires a second suspension, can the Commission issue the suspension after trading has resumed for a day? A week? A year? It is certainly unlikely that Congress intended that a single trading suspension would give the stock an immunity from all future summary suspensions.

As a result of the Securities Acts Amendments of 1975, certain other federal agencies enumerated in Section 12(i) of the Securities Exchange Act, 15 U.S.C. 78l(i), also are authorized to utilize Section 12(k) of the Act summarily to suspend the trading of securities of the institutions they regulate. Pursuant to this authority, both the Comptroller of the Currency and the Federal Deposit Insurance Corporation have issued summary ten-day suspension orders under Section 12(k) and, where appropriate, have ordered consecutive suspensions.[25/] The decision in this case, if not reconsidered, will thus impair not only the ability of the Commission, but also the ability of these other agencies, to protect investors.

25/ The Comptroller of the Currency issued orders which continuously suspended trading in the stock of Mercantile National Bank of Atlanta, Georgia, from May 13, 1976, to July 23, 1976 (31 Fed. Reg. 20592 (May 19, 1976); 41 Fed. Reg. 29436 (July 16, 1976)). The Federal Deposit Insurance Corporation has suspended trading in the securities of Farmers Bank of the State of Delaware from March 9, 1976, through June 15, 1976 (41 Fed. Reg. 10713 (March 12, 1976); 41 Fed. Reg. 23228 (June 9, 1976)), and in the securities of the Unity State Bank of Dayton, Ohio, from July 7, 1976, through July 26, 1976 (41 Fed. Reg. 28583 (July 12, 1976); 41 Fed. Reg. 30213 (July 22, 1976)).

Mootness.

As noted above (page 2), at the time this appeal was argued, there had been no Commission order in effect for more than five months that suspended trading in CJL stock. Thus, there does not appear to have been a case or controversy before this Court. The panel held, however, that the case was not moot because it found the Commission's "continuing policy of roll-over ten-day suspension orders . . ." resulted in harm to Mr. Sloan "'capable of repetition yet evading review,'" citing Southern Pacific Terminal Co. v. ICC, 219 U.S. 498 (1911); Sosna v. Iowa, 419 U.S. 393 (1975), and Weinstein v. Bradford, 423 U.S. 147 (1975) (slip op. 565-566). But the panel appears to have disregarded the language in Weinstein, the most recent of these cases, which held that a case is moot and does not present an issue "capable of repe-- tition, yet evading review" when the action is not a class action and "there is no demonstrated probability" that "the same party would . . . be subject to the same kind of order in the future." 423 U.S. at 149. In this regard the Supreme Court there declared (emphasis supplied):

> "Sosna decided that in the absence of a class action, the 'capable of repetition, yet evading review' doctrine was limited to the situation where two elements combined: (1) the challenged action was in its duration too short to be fully litigated prior to its cessation or expiration, and (2) there was a reasonable expectation that the same complaining party would be subjected to the same action again (emphasis supplied).

Here, as in Weinstein, the "instant case, not a class action, clearly does not satisfy the latter element" (id.).

Person Aggrieved.

Mr. Sloan owns CJL stock apparently worth less than $30. 26/ The panel found (slip op. 565 n.4) this ownership sufficient to confer standing on the

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26/ See page 2 and n.2, supra.

basis of Medical Committee for Human Rights v. Securities and Exchange Commission, 432 F. 2d 659, 667 (C.A. D.C., 1970). That case, however, having been dismissed as moot, 404 U.S. 403 (1972), "was stripped of value as a precedent . . . ."[27/] Mr. Sloan's only other interest in CJL stock was his desire to speculate.[28/] If the latter situation makes him a person aggrieved, "bystanders to the securities marketing process" would have the right to challenge a Commission suspension order. Cf. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 747 (1975). That case suggests that the Securities Exchange Act was not intended to so encourage litigation. We submit that Mr. Sloan had no standing as a person aggrieved to challenge the Commission's order.

Respectfully submitted,

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December 1976

27/ Cruz v. Skelton, C.A. 5, No. 75-2554 (decided November 22, 1976), slip op. 91, 94; Cook v. Whiteside, 505 F. 2d 32, 33 (C.A. 5, 1974); Ridley v. McCall, 496 F. 2d 213, 214 (C.A. 5, 1974).

28/ Although the panel stated that Mr. Sloan had standing because "the effect of the suspension on Mr. Sloan . . . is equivalent to an injunction preventing him from selling his shares" (slip op. 565, n.4), Mr. Sloan did not even contend in the instant case that he desired to sell his 13 shares of CJL stock. See p. 2, n.3, supra.